LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7183 | **NOTE PREPARED:** Jan 28, 2015
BILL NUMBER: HB 1485 | **BILL AMENDED:**

SUBJECT: Local Option Income Taxes.

FIRST AUTHOR: Rep. Thompson | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: The bill replaces the County Adjusted Gross Income Tax (CAGIT), the County Option Income Tax (COIT), and the County Economic Development Income Tax (CEDIT) with a local income tax. It also provides for the introduction of legislation in the 2016 legislative session to make related amendments to implement the local income tax.

Effective Date: Upon passage; January 1, 2016.

Explanation of State Expenditures: *Summary*- The bill requires the Office of Management and Budget (OMB) along with the appropriate agencies to perform certain tasks throughout 2015 in preparation for the conversion to the local income tax by August 1, 2015. However, the existing local option income taxes (LOITs) will be administered and distributed until December 31, 2015. The OMB should have sufficient resources to implement this bill.

Additional Information- Department of Local Government Finance (DLGF): During the transition, the DLGF is required to provide a uniform method of calculating levies, tax rates, and a uniform method of applying property tax credits. The DLGF is also charged with assisting the adopting bodies as necessary to transition to the local income tax.

The DLGF has the following administrative duties under the local income tax. They will electronically provide uniform notices, ordinances, and resolutions for the adopting bodies to use to take action. The DLGF will establish procedures to adopt an ordinance affecting the local income tax. In addition, the DLGF will compute the amount of property tax credits, school distributions, public safety revenue, economic development revenue, certified shares, and special purpose revenue that will be distributed to each taxing unit for the ensuing calendar year. The DLGF will provide this information to the appropriate county auditor 15 days after the estimated and final certified distribution is provided by the State Budget Agency (SBA).

State Budget Agency (SBA): The SBA is required to work with the DLGF to transition from the existing LOITs to the local income tax. They will likely assist in mapping the existing LOITs into the local income tax's rate components. The SBA may make a one-time adjustment to a tax rate to eliminate any additional revenue that would be collected once the local income tax is imposed on nonresident taxpayers. The SBA will certify an adjusted rate before August 2, 2015. In addition, the SBA will continue to determine the certified distribution as in current law.

Explanation of State Revenues:

Summary of NET Local Impact: This bill repeals CAGIT, COIT, and CEDIT effective January 1, 2016, and replaces them with a single local income tax. The transition to the local income tax must be completed by August 1, 2015. Notwithstanding transition errors, the implementation of the local income tax should have no impact on a county's certified distribution of income tax revenue. A county should continue to receive the revenue it would have under the existing LOITs.

However, there is a risk this bill will impact the revenue allocation for certain taxing units. The bill standardizes the local revenue allocation procedures. This could result in income tax revenue shifts among the civil units within a county. The total estimated revenue shift among civil units is $18.7 M which is less than 1% of the total CY 2015 statewide LOIT certified distribution.

Taxing units in some counties could experience a change in revenue from property tax collections due to LOIT's influence on the property tax circuit breakers. Changes to the property tax relief rate structure may cause some units to receive more property tax revenue while others may receive less.

With the repeal of the current LOIT laws, certain special permitted and required uses of LOIT revenue have also been repealed. However, the purpose statement in the bill may provide for the continuance of these options and requirements. This fiscal note assumes their continuance. These special uses include:

- Permit the use of COIT distributions before certified shares are distributed:
  - To fund county homestead credits.;
  - To fund emergency communications and computer facilities in Marion County;
  - To fund public library operations in Marion County; and
  - To fund a central Indiana public transportation project.
- Require the second 0.25% of Porter County's CEDIT rate to be used for transfers to the Northwest Indiana Regional Development Authority and for county homestead credits.
- Allow CEDIT revenue to be redirected to a specific civil unit through the adoption of a capital improvement plan.
- Use CEDIT revenue for homestead credits to mitigate tax shifts from the elimination of inventory assessments.

Explanation of Local Expenditures: The adopting bodies will remain the same for each county that currently imposes a LOIT. The process to impose local income tax ordinances will be established by the DLGF and no actions taken by the adopting bodies are effective unless they satisfy all the requirements prescribed by the DLGF. The adopting bodies may not take any actions between June 30, 2015 and July 1, 2016.

After the transition period, the adopting bodies can adjust the total tax rate and specify by ordinance how the revenue will be allocated among the available uses. The effective date of the allocation of local income tax revenue depends on the date the ordinance is adopted. An ordinance adopted between January 1 and November 1 of the current year, goes into effect on January 1 of the following year. If an ordinance is adopted between November 1 and December 31 of the current year, it goes into effect on one year after January 1 of the following year.

<u>Explanation of Local Revenues:</u> *<u>Summary</u>* - A county should receive the same amount of total revenue from the local income tax as they did under LOIT. However, the bill does align the methods of allocating the income tax revenue among civil units within a county which may lead to shifts among certain units. The allocation of tax revenue within a county depends on how the revenue is mapped to a specific rate component.

The DLGF will provide the initial classification of local income tax rates using the former tax rates or using the dollar amounts that were dedicated for specific purposes.

<u>Additional Information</u> - There are three rate components of the local income tax*, expenditure rate*, *property tax relief rate*, and *special purpose rate*. The revenue collected from a rate component may only be used for purpose established in the bill. Each rate component serves a function similar to an existing LOIT. The table below shows how the existing LOITs will likely be mapped to a local income tax rate.

<table>
<tr><th colspan="7">LOIT to Local Income Tax Rate Comparison</th></tr>
<tr><th colspan="4">Current Statute</th><th colspan="3">Proposed</th></tr>
<tr><th>LOIT</th><th>Purpose</th><th>CAGIT County</th><th>COIT County</th><th>Rate Component</th><th>Sub-Allocation</th><th>Rate</th></tr>
<tr><td>CAGIT/COIT</td><td>Budgetary</td><td>1.0%</td><td>1.0%</td><td rowspan="4">Expenditure*</td><td rowspan="4">•Certified Shares
•Public Safety
•Economic Development</td><td rowspan="4">2.5%</td></tr>
<tr><td>LOIT for Levy Freeze</td><td>Budgetary</td><td>1.0%</td><td>1.0%</td></tr>
<tr><td>Public Safety LOIT*</td><td>Public Safety</td><td>0.25%</td><td>0.25%</td></tr>
<tr><td>CEDIT**</td><td>Economic Development</td><td>0.25%</td><td>0.0%</td></tr>
<tr><td>LOIT for Property Tax Relief</td><td>Property Tax Relief</td><td>1.0%</td><td>1.0%</td><td rowspan="2">Property Tax Relief</td><td rowspan="2">n/a</td><td rowspan="2">1.0%</td></tr>
<tr><td>CEDIT for Homestead</td><td>Property Tax Relief</td><td>0.25%</td><td>0.25%</td></tr>
<tr><td>Special Purpose</td><td>Special Projects</td><td>varies</td><td>varies</td><td>Special Purpose</td><td>n/a</td><td>varies</td></tr>
<tr><td colspan="2">Total Rate*</td><td>3.75%</td><td>3.50%</td><td colspan="3">3.50%</td></tr>
</table>

*The maximum tax rate for Marion County is 0.25% above the listed tax rate.
**Maximum possible CEDIT rate if the full CAGIT or COIT rate is adopted.

The *expenditure rate* is combination of CAGIT, COIT, CEDIT, LOIT to Freeze Property Tax Levy, and public safety LOIT. The maximum *expenditure rate* for all counties other than Marion County is 2.5%. The maximum rate for Marion County is 2.75%. Revenue from the expenditure rate may be allocated for public safety, economic development, and certified shares. The allocation is established by an ordinance adopted by the county's adopting body. However, all former CAGIT counties must provide the first 0.25% of the expenditure rate revenue to all civil taxing units including school corporations.

The public safety expenditure rate allocation is used like the current public safety LOIT revenue. The public safety allocation is distributed to the county and municipalities that provide a qualifying service. The public safety distribution formula under the local income tax is identical to the formula currently used by COIT counties. Counties that have adopted the public safety LOIT under CAGIT will experience a shift in revenue among the qualifying units.

The economic development expenditure rate revenue may be used for the same purposes as current CEDIT revenue. The revenue is distributed to the county, cities and towns like CEDIT. However, the local income tax uses a different formula to distribute the revenue. It reduces a unit's basis by any amounts appropriated from property taxes to pay obligations or leases entered into after June 30, 2005, like the current formula for distributive and certified shares. This change may impact the economic development revenue allocated to local units.

The remaining expenditure rate revenue is allocated to certified shares. The certified share revenue is distributed all civil units that impose an ad valorem property tax except school corporations. (The majority of the members of the county fiscal body may agree to include a solid waste management district in the calculation of certified shares.) The allocation formula for certified shares under the local income tax is the same as the CAGIT formula. In addition, taxing units with no property tax levy and new taxing units in their first year will no longer get distributions. Distributions of certified shares may be used for any lawful purpose.

The bill contains a separate distribution formula for Marion County that replaces a formula in current law that applies only to Marion County. The new formula distributes Marion County's certified shares in the same proportion as they were distributed in 1995. This change will result in a shift in the distribution of certified shares among the civil taxing units in Marion County.

The new revenue distributions under this bill were simulated using 2015 LOIT revenue data and were then compared to the 2015 certified distributions. The simulation did not include any special purpose tax rates or any portion of certified distributions that may be directed to other special purposes before the remainder is distributed to units. The total amount of revenue shifted between taxing units is $18.7 M with Marion County accounting for about$10.5 M of the total. The reductions come from 1,059 taxing units while the increases go to 329 units. The total revenue in any county is unchanged.

The tax collected from the *property tax relief rate* is to be treated as property taxes for all purposes except by the DLGF in computing maximum levy limits. The tax may be used only to fund a property tax credit to reduce property tax liabilities. It can be allocated to (1) homesteads, (2) real property subject to the 2% tax cap, (3) real and personal property subject to the 3% tax cap, or (4) any combination of the three. Within each category, the property tax credit rate must be at the same percentage for all taxpayers with property in the county. This rate replaces the LOIT for Property Tax Relief. The rate may not exceed 1%. [The bill eliminates the additional revenue capacity to provide homestead credits under CEDIT.]

Currently, the LOIT for Property Tax Relief may be used to provide credits for (1) homesteads, (2) qualified residential property (homesteads, nonhomestead residential, and apartments), and (3) all real and personal property. The county may adopt the credits in any combination of these three categories.

The permitted uses in the bill differ as follows:

- •A county may no longer adopt credits for qualified residential property without including the remainder of the 2% capped property.
- •A county will be able to adopt credits for 3% capped property without applying credits to all other property as well.

Some counties may not be able to allocate their new LOIT Property Tax Relief credits in exactly the same manner as they do currently. A change in the taxpayers who receive the credits or in the amounts that each taxpayer receives may have an impact (positive or negative) on circuit breaker losses for some civil taxing units and school corporations. The impact depends on local variables and on the way in which each county's credits are allocated.

Nine counties currently allocate all or a part of their LOIT property tax relief revenue to qualified residential property. The counties include Adams, Clay, Clinton, Grant, Huntington, Jay, Miami, Wabash, and Wells.

Additionally, these property tax credits will no longer apply to the portions of property tax bills that are the attributable to a referendum levy or levy for debt incurred after June 30, 2005.

A *special purpose rate* is a distinct rate implemented for a specific purpose by a particular county. For example, Union County may impose a restricted rate of up to 0.25% in addition to all other rates for the sole purpose of renovating their county courthouse. The most common use of restricted purpose rates are to fund the construction and operation of correctional facilities. The tax collected from this rate must be deposited in a separate account, and sufficient records must be maintained to demonstrate the revenue is used only for the designated purpose. These rates can vary depending on the project.

Excluding special purpose rates, the maximum local income tax rate is 3.5% for all counties except Marion County. The maximum rate for Marion County is 3.75%. The revenue capacity for COIT counties is identical to current law. However, the bill reduces the revenue capacity for CAGIT counties by 0.25%.

All future fiscal impacts would depend on local decisions.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue; State Budget Agency.

Local Agencies Affected: Counties with a local option income taxes.

Information Sources:

Fiscal Analyst: Heath Holloway, 232-9867; Bob Sigalow, 232-9859